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THE MAGAZINE FOR GROWING COMPANIES

AUG. 1988
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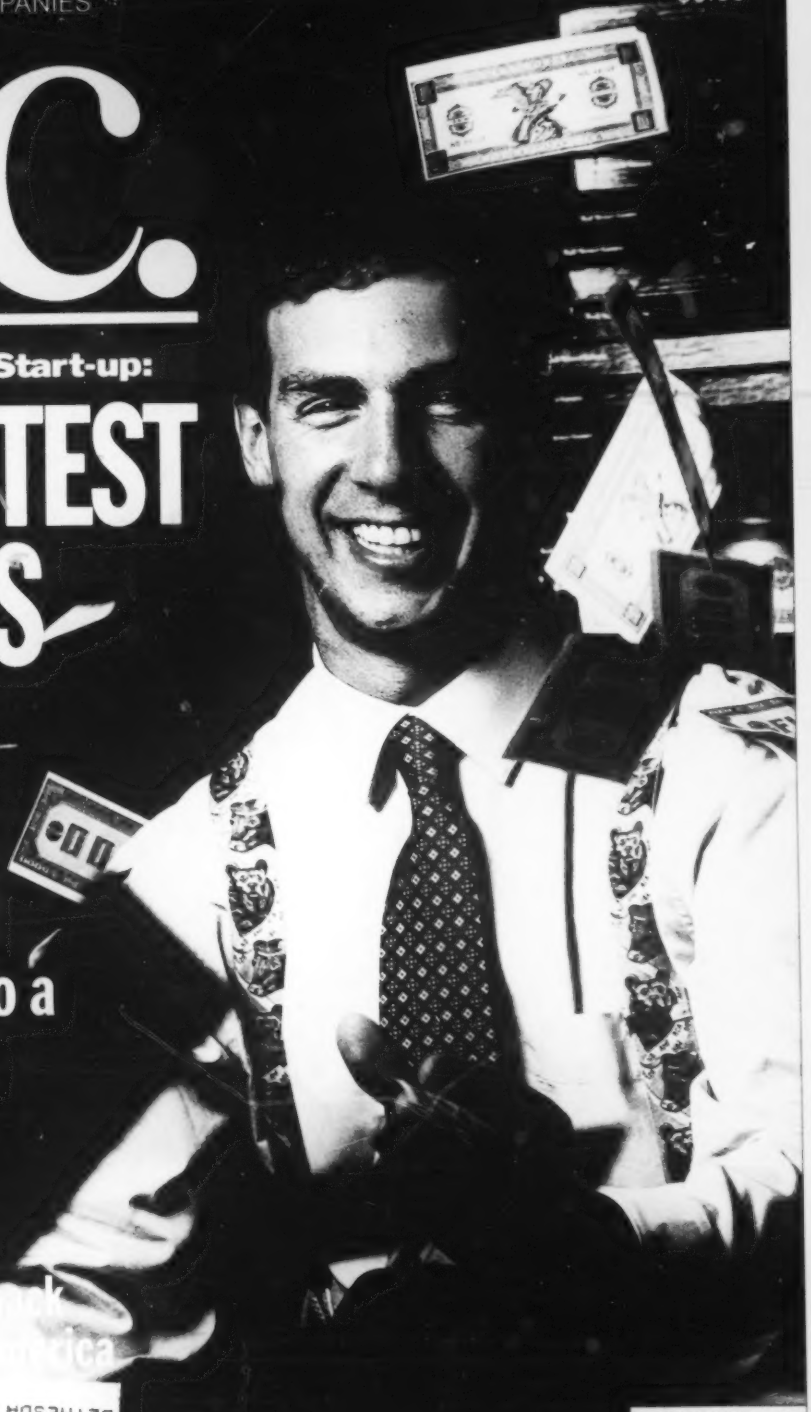
The Anatomy of a Start-up:

THE HOTTEST BUSINESS GAME IN TOWN

Turning a Fad into a Growth Business

PAGE 50



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TIMOTHY A. DeMELLO,
FOUNDER OF WALL STREET GAMES INC.

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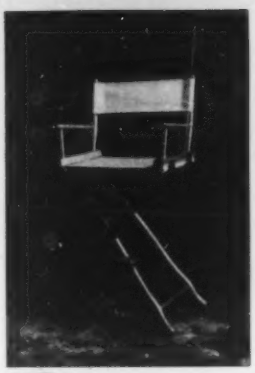

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LETTERS

WHERE'S THE HEART?

The relationship between business and personal values was also evoked in the responses to May's Anatomy of a Start-up, "Rooms with a View," about the Queen Anne Inn, a bed-and-breakfast in Denver.

Your article is destined to become a classic in the bed-and-breakfast world, where so many wonder if there is money to be made in such a highly personalized business. It brought to mind the successful B and B owner who—after listening to a bottom-line conference speaker—asked, "Where's the heart?" Lifestyle is the primary reason for going into the B and B business, and burnout the primary problem, even among hosts who have been forewarned. Hence we see owners moving next door, and turning their host duties over to a new kind of professional, the inn-sitter.

Bernice Chesler
Author
Bed & Breakfast in New England
Newton Highlands, Mass.

As a bed-and-breakfast owner, I found your article a real eye-opener, and about two years too late. Most B and B stories focus on the wallpaper and overlook the nickel and dime of it, which is really most important. At 48, I am probably earning about $2.35 an hour, but I have three beautiful acres of plants, lawns, and weeds, and a wonderful 1898 Victorian home. After 18 frantic years in New York City, I have no tremendous desire to collect possessions or to change my business and lifestyle. Nevertheless, your guest experts hit the mark in talking about the limited potential of a B and B as a real business.

Peter Goldfarb
Owner
The White Swan Guest House
Mount Vernon, Wash.

MINDING YOUR OWN BUSINESS

The issue of values is clearly on readers' minds these days, and it is one that seems to arise wherever you look in a business. It surfaced again in one reader's response to Paul B. Brown's marketing column, "The Ostrich Gambit" (May), about recreational-vehicle tour master Larry Olsen, who defies the conventional wisdom and ignores what his competition is doing.

I get the impression from Olsen's quotes that he doesn't really ignore his competitors but simply refuses to worry about them. Rather than trying to eighty-six somebody else's business, he invests his time in improving and promoting his own. This has two very important effects. First, it gives him more time to do his planning; second, it takes away a lot of stress.

I learned the value of this approach when competitors began attacking the quality of my service. I wanted revenge, but my wife convinced me not to respond at all. To respond, she argued, would suggest that I had some reason to defend myself against false claims. As it turned out, she was right. We never lost a customer, and my competitors succeeded in enhancing our image while tarnishing their own.

What really concerns and scares me are the views of the marketing consultants Brown quotes. If it were up to them, the Super Bowl would never be played: one team would just blow up the other team's bus on the way to the game and proclaim itself world champion. These experts think it's fine to attack competitors any way you can, above or below the belt. How long does it take before this attitude creeps into your relationships with customers, and then into your personal life?

Larry Olsen would probably say that it is better to stress quality and honesty in every situation. That way, you will always be consistent in your decisions. Employees and customers will be easier to deal with because they'll all know what to expect from you. That's really how Olsen deals with his competitors—not by ignoring them, but by minding his own business, and by having the confidence to know he'll always be a few steps ahead.

Robert Wellnitz
President
Trux
Modesto, Calif.

POSTSCRIPTS

We also heard from readers who wanted to add something to articles we had published. One letter, for example, praised Robert A. Mamis's piece, "Attack of the Bears" (May), concerning the stock performance of this year's INC. 100 companies, but suggested that Mamis had overlooked an important reason for the diminished luster of small-cap stocks.

Many small companies that go public are not prepared for the challenges they will face in the aftermarket. No one warns them about the investment of time and money it takes to maintain favorable relations and valuations from investment professionals. Without a plan to market their companies to analysts and fund managers, they end up with undervalued and underfollowed stocks. In the short term, shareholders pay the price in reduced value. Longer term, an important financing avenue is closed. Lots of well-financed companies have small stock-market valuations, and many would be well served by LBOs. For those that seek continued access to the public market, however, active marketing of the company story can generate much stronger and more consistent support than your article suggests.

Michael Rosenbaum
Partner
The Financial Relations Board Inc.
Chicago

For candor's sake, we should note that Mr. Rosenbaum earns his living by marketing company stories to the financial community. Nevertheless, his point is well taken.

Another reader elaborated on an issue raised by John Case in his June article, "ESOPs: Dead or Alive?" which introduced our Owner's Manual series. In the article, Case recounted the story of Henri Bertuch, who sold 30% of his stock in his company to an ESOP and then reinvested the proceeds in other U.S. corporate securities, thereby deferring the tax on his gains. Case noted that—if Bertuch dies before selling the new assets—his heirs can avoid income tax on the gains entirely. That's where our correspondent picks up.

Case omits an important point. Once you roll over your owner's stock into a qualified replacement stock, it can't be rolled over again without incurring a tax. It must stay in the same domestic corporate security you have chosen as your initial replacement stock. If, for instance, the replacement company were acquired and you had to sell the stock, you'd be forced to pay taxes on the entire gain, not just the gain in the value of the replacement stock. That's a very important consideration, seldom noted in the ESOP literature.

James H. Carrington
Chairman of the Board
Season Air Inc.
Rockville, Md.

HOUSE OF CORRECTIONS

Finally, we'd like to apologize to the owners and employees of two companies that were mistakenly disqualified from the 1988 INC. 100. One is ISOETEC Communications Inc., of Darien, Conn., which manufactures and sells business communication systems. It had a five-year growth rate of 3,345%, which should have earned it the 39th spot on the list. We also failed to include Texcel International Inc., in Mineola, N.Y., a manufacturer of air pollution–control systems. With a five-year growth rate of 3,231%, it should have ranked #41.

INC. wants to know what you think. Please address all correspondence to INC. Letters Editor, 38 Commercial Wharf, Boston, MA 02110, or call our editorial commentary line toll free at (800) 444-1756. (Messages will be recorded.) Please include name, address, and telephone number for verification. Letters must be signed, and all correspondence may be edited for space and style.

HANDS ON

A Manager's Notebook

Nearly all companies responding to a Bureau of National Affairs Inc. survey use prizes to reward performance or achievements ranging from service milestones to productivity. Among the companies that have an award program, here is the breakdown.

Source: The Bureau of National Affairs Inc., Personnel Policies Forum survey, 1987

RESOURCES

PERSONALIZED WISDOM

The problem with new books is that they keep you from rereading the old ones, retailer Stew Leonard says. "You're so busy trying to keep up with what is coming out that you can forget what you've already read. And it's hard to convince yourself to go back and reread a 300-page book."

The owner of Stew Leonard's, in Norwalk, Conn.—an enterprise *Ripley's Believe it or Not!* calls the world's largest dairy store—has come up with a solution.

As he reads useful texts, Leonard underlines passages he likes and scribbles notes in the margins. When he's done, his secretary types up everything he's marked, and he has a 20- to 30-page summary—which, Leonard says, is better than anything he could buy, because he has personalized it to his business. Periodically, he goes back and rereads his summaries.

"You can also give your outlines to employees," Leonard adds. "If you give them a 300-page business book, they'll never read it, because it's too long. But they'll read 30 pages." □

MARKET RESEARCH

SECONDHAND KNOWLEDGE

The market-research budget is often among the first to get trimmed when growing companies suffer a cash crunch. Now, there's a way to fill at least some of the gap—and cheaply.

A service called Marketsearch lists more than 18,000 research studies on U.S. and foreign markets by business and industry professionals, consultants, and entrepreneurs. Some of the surveys, which were released within the past five years and cover everything from ammunition to zippers, sell for less than $100.

Subscribers to Marketsearch pay $195 a year and receive the annual directory, a midyear supplement listing new studies, and access to a hot line providing up-to-the-minute data on recently released surveys. Look for it at a business library or write to: Marketsearch, P.O. Box 5228, Evanston IL 60204. □

MANAGING PEOPLE

HERE COME THE JUDGES

At most companies, it's an annual rite for employees to sit down with their bosses and review their strengths and weaknesses. After all, who can better judge employees' performance than their immediate superiors?

Warren Rodgers can think of some. Why not let employees rate themselves? says the president of Computer Specialists Inc., in Monroeville, Pa. And if you're in a service business, you may be overlooking an obvious critic: your clients. They may see your employees more often—and in a greater variety of circumstances—than you do.

Twice a year, Rodgers asks his clients and each of his 150 employees to fill out evaluation forms. Then, he and the employee compare the two evaluations. "If people feel the quality of their work is an 8 out of 10, and the client feels it's a 4, there's trouble," says Rodgers. □

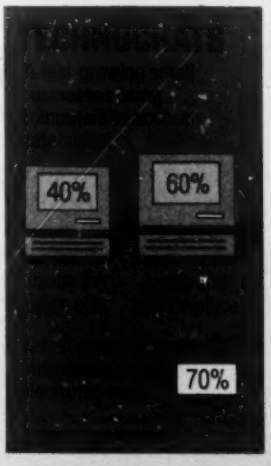
STRATEGY

IS THERE A LAWYER IN THE HOUSE?

You may want to reconsider inviting your lawyer to be on your company's board of directors. The trouble, says Dennis O'Connor, an attorney with a Waltham, Mass., firm specializing in corporate law, is that things can get confusing when a lawyer is asked to wear two hats—those of business adviser and legal counselor. "There's a gray area in between, and it can be hard for a CEO who acts counter to a lawyer's recommendation to know whether he is risking an illegality or simply disagreeing on business strategy," O'Connor says.

An experienced board member himself, O'Connor says it's standard policy at many law firms to sit on the boards of companies they advise, making it difficult for clients to sever the relationships. His own firm has taken a different—and he thinks healthier—approach. O'Connor attends as many as eight board meetings a month, but only as a nonvoting legal and business adviser. Under these well-defined circumstances, in which the voteless attorney wears only a legal hat, having a lawyer attend meetings is a must, O'Connor says.

"Many companies try to save money by not having a lawyer present at all, but that can hold up a decision when a director wheels around and says, 'Let's see what the lawyer has to say about this,' and there's no lawyer there." □



CHARTS: CYNTHIA DAVIS

HANDS ON

LAW

SPELL IT OUT

If you don't have a written description of the medical and insurance benefits your company provides, get out a typewriter. Under Section 89k of the tax code, which should take effect on January 1, 1989, such policies must be in writing to remain tax exempt. In addition, workers must receive reasonable notification of their benefits and have legally enforceable rights—so that they could sue if benefits were arbitrarily denied.

The new provisions are easy to comply with, says John Egner, senior legal counsel for The Johnson Cos., an employee benefits and compensation consulting firm. The key: a summary plan description distributed to all employees—something many smaller companies have done without. Employers must also provide descriptions of such perks as company-subsidized cafeterias and employee discounts, notes John Eggertsen, a Detroit attorney specializing in benefits law. "I'd be surprised if one out of 10 small employers gives adequate descriptions to its employees," he says. □

QUOTE OF THE MONTH

'We don't want to ruin a business relationship by having a haphazard, obnoxious bill collector. Keeping up on late payers is like shaving—if you don't do it every day you look like a bum.'

—William Donohoo of The Gibson Group Inc., in Cincinnati, a paperboard broker whose thin margins make low receivables a requirement, not an option

COST CONTROL

A PRESCRIPTION FOR SAVING MONEY

You're not the only one who's eager to battle the rising cost of medical insurance. After watching his company's premiums increase by more than $500,000 over five years, Jack Stack of Springfield Remanufacturing Center Corp. (SRC) gambled on a way to slow the tide: SRC now self-insures the prescription-drug portion of its insurance plan.

Under the previous program, employees filled prescriptions without ever seeing a bill. Since there was no incentive to limit costs, price was never an object—and the big spending resulted in premiums that were about to run SRC $70,000 a year. Well, Stack decided, why don't we pay for the prescriptions ourselves, arrange for volume discounts, and give employees a reason to think twice about costs?

It worked. SRC canceled its prescription-drug insurance, struck off-price deals with area pharmacies in grocery chains, and offered a special bargain-rate deductible on purchases of generic drugs. Encouraging the use of generics—something insurance companies don't do—can reduce the prescription-drug outlay of the company's 425 employees and their families by more than 40%.

How has the change affected the program as a whole? What would have been a $5,000-per-month insurance bill is now a $1,800-per-month pharmacy bill. That will add up to almost $40,000 in savings for SRC this year. □

BUSINESS TRAVEL

THE FRIENDLIEST SKIES

OK, admit it. There's something about saying, "Oh, I flew in on the company jet. . . . " That's besides all the productivity and morale benefits some say a corporate craft provides. But how much does actually *buying* a business plane cost?

According to Sabreliner Corp., the average new business jet will set you back $5 million to $6 million, and the average used jet goes for $500,000 to $3 million. If you go low end, and use your plane four hours a week, annual operating costs are likely to average $300,000.

It's an attractive travel alternative if you can afford it. According to the National Business Aircraft Association, more than 800 used business planes and 220 new ones were sold in 1987.

Still interested? Sabreliner has a free workbook to analyze the costs and benefits of ownership. Write to: Sabreliner, 6161 Aviation Dr., St. Louis MO 63134. □

KEEPING COUNSEL

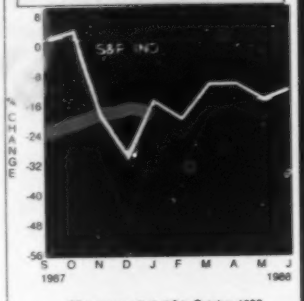
Type of counseling	% companies offering such counseling under an employee assistance program
Alchohol/drug abuse	40%
Emotional/stress	37
Preretirement	30
Marital	26
Termination	24
Career	22
Financial	22
Legal	16

For those employee assistance programs, some or all of which are paid for by the company, exist in 45% of surveyed companies.

Reported by Leslie Brokaw, Paul B. Brown, Joshua Hyatt, Teri Lammers, Martha E. Mangelsdorf, and Amy Schuman

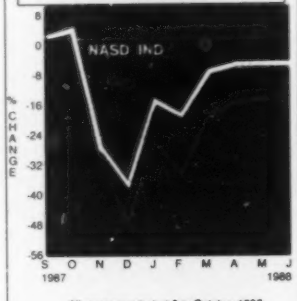
INVESTING IN GROWTH COMPANIES

INC. vs. CONSERVATIVE AVERAGES



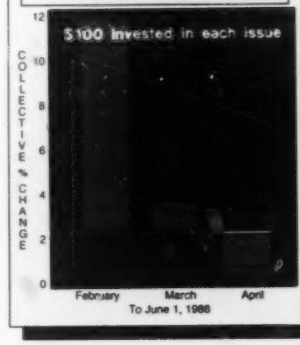
All averages start at 0 in October 1987.

INC. vs. SPECULATIVE AVERAGES



All averages start at 0 in October 1987.

IPOs IN THE AFTERMARKET



INITIAL PUBLIC OFFERINGS: MAY 1988

O-T-C sym.	Company	Business/product	Offering Size ($mil.)	Offering Price	First aftermarket bid	Underwriter
SI[a]	ACM Government Spectrum	Closed-end fund	270.00	10.00	11⅜	Paine Webber
BFSI	BFS Bankorp	S&L	2.32	7.00	7	Merrill Lynch
BMRG	BMR Financial Group	Bank holding co.	8.55	9.50	9½	Alex. Brown
LTG[b]	Catalina Lighting	Mfrs. light fixtures	3.22	3.50	3⅞	Werbel-Roth
CBOG	Community Bancshares	Bank holding co.	7.25	7.25	7¼	Robinson-Humphrey
CMAT	Compumat	Mkts. computers & software	3.80	4.75	4⅞	Oberweis
CPF[a]	Comstock Partners Strategy	Closed-end fund	1,100.00	10.00	10	Merrill Lynch
CYTBU	Cytrx Biopool Ltd.	R&D of vascular-syst. prods.	6.00	6.00[c]	6¼	D. H. Blair
FRMG	Firstmiss Gold	Dvlps. gold mine	13.00	8.00	7¾	Shearson Lehman
FCX[a]	Freeport McMoRan	Holding co.	65.63	17.50	17¾	Kidder, Peabody
HBUF	Homestyle Buffet	Restaurant chain	3.80	6.50	7	Oberweis
ICAR	Intercargo	Ships cargo	4.64	6.25	6½	Blunt Ellis
MYOTU	Myo-Tech	Mfr. & mkts. medical testing device	3.75	5.00[c]	5½	D. H. Blair
PIF[a]	Pru Intermed Income	Closed-end fund	470.00	10.00	10	Prudential-Bache
RELY	Relational Technology	Mkts. software	28.00	14.00	14⅝	Goldman, Sachs
RESP	Resperonics	Designs & mfrs. respirator prods.	6.00	12.00	12	Parker/Hunter
RCHFA	Richfood Holding	Food distr.	19.38	7.75	8	Paine Webber
SGHI	Silk Greenhouse	Operates synthetic-flower stores	12.08	11.00	13½	Robertson Coleman
BID[b]	Sotheby's Holdings	Auctions art	52.26	18.00	18	Salomon Bros.
TSO[b]	T2 Medical	Operates home-care infusion therapy units	12.00	8.00	8	Drexel Burnham
TNN[a]	Teleconnect Co.	Diversified telephone syst.	57.60	18.00	18	Merrill Lynch
TJCK	Timberjack	Mfrs. logging equipment	13.80	12.00	12	Kidder, Peabody
USM[b]	United States Cellular	Owns & operates cellular phone service	42.00	15.00	15	Salomon Bros.

Initial public offerings sold at $1 or less not included; issues without underwriters not included. First aftermarket bid is approximate. [a] trading on NYSE, [b] trading on AMEX; [c] units of 3 common + 3 warrants. Offering data source: *GOING PUBLIC: THE IPO Reporter*, a publication of The Dealer's Digest Inc., 150 Broadway, New York, NY 10038.

STREET TALK Among the most convincing proofs of the theory of contrary opinion—which holds that the market never does what the majority expects it to do—has to be the 75-point rally of the DJI on May 31. At that time, stocks had been meandering down from their mid-April post-crash high, and to many, it looked as if they were taking aim at 1,800 again. Technicians who measure bullish versus bearish sentiment reported that the bull/bear imbalance was at its most severe since the 1981–'82 period—when the DJI was at 800. Last May the ratio among market-letter writers was about 30% bullish to 55% bearish. The DJI then leapt from under 2,000 to over 2,100 in less than two weeks. That surge not only lent credence to contrarians' beliefs, but supports the view that at critical junctures, professionals know little more than the rest of us. *—Robert A. Mamis*

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Cov. 1, Pgs. 7, 30, 31, 78-80,

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THE MAGAZINE FOR GROWING COMPANIES

SEPT. 1988
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THE NEW AMERICAN START-UP

Large-Company Refugees like Mary Anne Jackson Take a Different Approach to Building a Business

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MARY ANNE JACKSON
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COVER PHOTOGRAPH
by
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LATE BLOOMERS

Among companies, as among people, it's the young from whom we expect the serious growing. We're wrong

BY DAVID L. BIRCH

Most people think companies are like cows—growing a lot when young and then very little thereafter. It's part of a natural tendency to ascribe a biological model to practically everything. And when we think of fast-growing companies, the tendency is compounded. We already know that rapid growers are likely to be small—and we are quick to equate small with young.

It turns out that we're mistaken.

Companies, unlike cows, are regularly "born again." They take on new management, stumble onto a new technique, or benefit from a change in the marketplace. Whatever the cause, statistics show that older companies are *more likely* to grow rapidly than even the youngest ones.

Look at company growth by age group (figure 1). The very youngest group of businesses has a relatively high concentration of rapid growers (as determined by an index combining percentage and absolute growth), but not the highest concentration. The rates fall off until the ripe old age of 40 or so, after which they begin to accelerate. The group with the largest concentration of rapid growers consists of companies 75 years old and older.

Well, you might argue, if older companies can, in fact, continue to grow, maybe it's because they get bigger over time and acquire the resources to grow by leaps again.

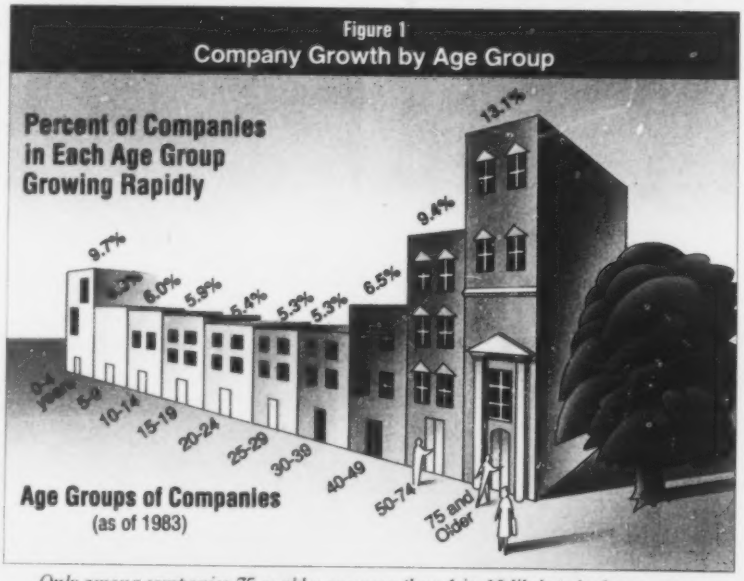
There's some truth to that—but not much. More than two-thirds of all rapidly growing companies 10 years old and older are small (fewer than 100 employees) when they begin their growth. It appears that a smaller business can come alive at almost any time in its existence, and that a lot of them do.

We discussed in last month's column the fact that entrepreneurship is a hard grind. Maybe now we know why: it's a grind that's endless. There is potential for explosive growth throughout a company's life: it's a planted seed, waiting for the right combination of water and light to bring it alive. Older companies, it stands to reason, may provide the most fertile soil—having accumulated the cash flow, wisdom, and experience to recognize and take advantage of opportunity when it presents itself.

If your company needs to identify the rapid growers (to sell to, work with, or invest in), there's a simple message. You can't assume that the growth-company clichés—young high-tech hot shots—describe your only, or even your best, target. With more growth concentrated above 10 years of age than below it, it pays to look carefully at the older generation.

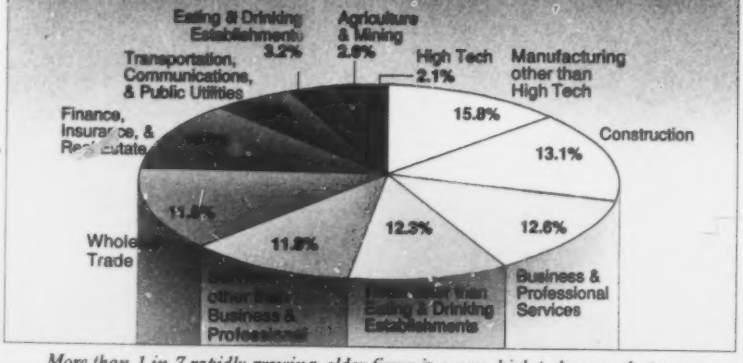
And what will you find when you do? A pattern not at all in accord with most stereotypes (figure 2). High tech is the

Figure 1
Company Growth by Age Group



Only among companies 75 or older are more than 1 in 10 likely to be fast growers.
Not even start-up companies have as good a chance for growth as old ones.

Figure 2
What the Older, Fast-Growing Companies Do



More than 1 in 7 rapidly growing, older firms is a non–high tech manufacturer.
High tech is the smallest source of fast-growing companies at least 10 years old.

CHARTS: SAM WARD

smallest source of growing, older companies. (Apparently, high-tech companies *are* like cows—rarely growing except when young.) Too often, and with encouragement from the business press, people assume that most high-tech companies are growing—and worse, that most growing companies are high tech. Perhaps it's understandable that the cowlike tendencies of high-tech businesses get projected onto all companies. The reality, however, is that the growth patterns of high-tech companies are the exception, not the rule.

Older companies are not only more likely to be rapid growers, they're attractive in other ways, too. They're less likely to fail, less volatile, and more experienced.

Second only to the high-tech stereotype is the myth that most other growing, small companies sling hamburgers and peddle beer. In fact, among older growers, eating and drinking establishments are only a tad above high tech at the bottom of the list.

What's at the top of the list may be equally surprising to those who haven't been regular readers of this column. The greatest source of growing, older companies is general-purpose, low-tech manufacturing. So it isn't just start-ups that have rekindled the manufacturing sector. The obituaries for old-line manufacturing companies appear to have been premature. No other sector during the past four years has produced more growing businesses.

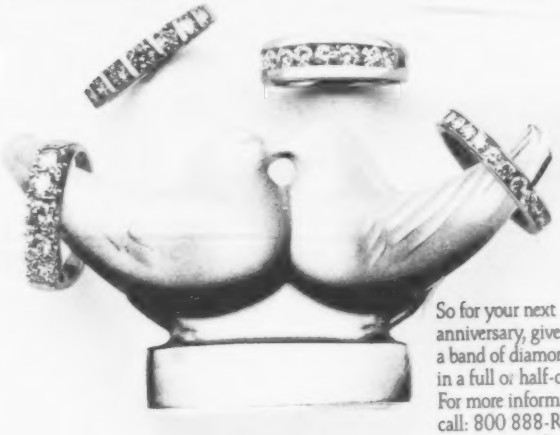
In general, the recent fortunes of older companies make it clear that innovation and creativity are not one-shot affairs. Companies can and do grow rapidly at almost any time in their histories.

Older companies are not only more likely than young ones to be rapid growers; they are in many ways more attractive. They are less likely to fail or be volatile, are more experienced, and have managed to satisfy investors and meet payrolls for a long, long time.

Forget the cow. Perhaps we'd do better to think of companies as wine. □

David L. Birch is president of Cognetics Inc., in Cambridge, Mass., and director of MIT's Program on Neighborhood and Regional Change.

Traditionally, the 15th anniversary should be celebrated with a gift of crystal.
(But then again, you were never bound by tradition.)



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EXECUTIVE COMPENSATION '88

THE TAKE AT THE TOP

Are growth-company CEOs the most underpaid businesspeople in America?

Love or money? INC.'s 1988 executive compensation survey presents us with a riddle of motivation.

Sure, the pay of the average growth-company CEO is now $97,000, up some 27% over five years ago. Which is not bad—enough, certainly, to keep our hero in Chevies (see "CEOs Behind the Wheel," page 86). Still, salaries *do* look greener on the other side of the entrepreneurial fence. And if lucre isn't what we do it for, well, what is?

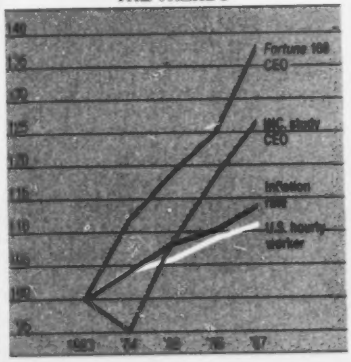
INC.'s surveyed CEOs have outstripped the five-year inflation rate by almost two to one—and this at a time when the average U.S. hourly worker didn't even keep up with the cost of living. *Fortune* 100 CEOs, however—they of the mass layoff and burgeoning trade gap—have hiked their take almost 40% over the same period. Today they make *nearly a million dollars more* than the typical company builder.

We could muddy the issue, of course. We could talk about long-term equity appreciation, lifestyle payoffs, or psychic reward—all the stuff you don't get if you worship P&Ls for GM. But why? Just look at the stats and say it: these folks are underpaid—*but that's not what it's about.* It's about passion, creativity, the grand crusade.

Money be damned. Love wins.

Competitive Analysis: How CEO Pay Stacks Up

THE TRENDS



IT'S ALL RELATIVE

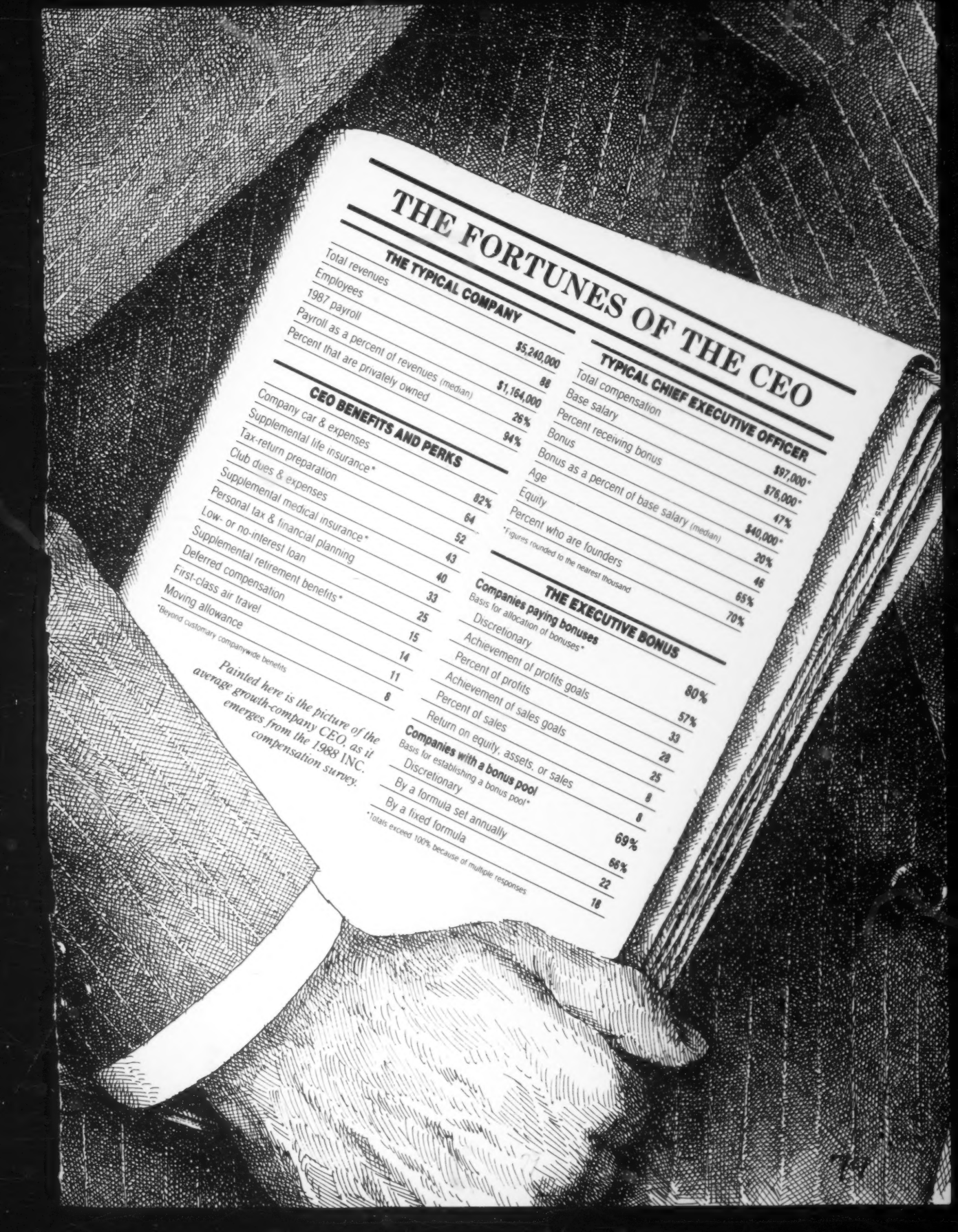
Fortune 100 CEO	$1,075,000
Major-league baseball player	447,291
Japanese CEO ($100-mil. firm)	187,300
Doctor	112,790
Lawyer	101,455
INC.-surveyed CEO	
Four-star general, U.S. Air Force	72,000
First-year investment banker	65,000
Magazine editor-in-chief	49,000
Plumbing crew foreman	39,000
Public schoolteacher	28,000

JUDGING THYSELF

CEOs believe that, if they worked for someone else and had comparable responsibilities, their total compensation would be:	
Higher	52%
Lower	20
About the same	28
CEOs believe their compensation for fiscal 1987 was:	
Too low	45%
Too high	2
About right	53

Excepting the downtick in 1985, the pay of INC.-surveyed CEOs has nearly kept pace with that of Fortune *100 heads—in percentage terms. In gross terms, things look different. Big-company compensation is up $300,000, growth-company compensation $21,000.*

ILLUSTRATIONS, ANATOLY



THE FORTUNES OF THE CEO

THE TYPICAL COMPANY

Total revenues	$5,240,000
Employees	88
1987 payroll	$1,164,000
Payroll as a percent of revenues (median)	26%
Percent that are privately owned	94%

CEO BENEFITS AND PERKS

Company car & expenses	82%
Supplemental life insurance*	64
Tax-return preparation	52
Club dues & expenses	43
Supplemental medical insurance*	40
Personal tax & financial planning	33
Low- or no-interest loan	25
Supplemental retirement benefits*	15
Deferred compensation	14
First-class air travel	11
Moving allowance	8

*Beyond customary companywide benefits

TYPICAL CHIEF EXECUTIVE OFFICER

Total compensation	$97,000*
Base salary	$76,000*
Percent receiving bonus	47%
Bonus	$40,000*
Bonus as a percent of base salary (median)	20%
Age	46
Equity	65%
Percent who are founders	70%

*Figures rounded to the nearest thousand

THE EXECUTIVE BONUS

Companies paying bonuses	
Basis for allocation of bonuses*	
Discretionary	80%
Achievement of profits goals	57%
Percent of profits	33
Achievement of sales goals	28
Percent of sales	25
Return on equity, assets, or sales	8
Companies with a bonus pool	8
Basis for establishing a bonus pool*	
Discretionary	69%
By a formula set annually	66%
By a fixed formula	22
	18

*Totals exceed 100% because of multiple responses

Painted here is the picture of the average growth-company CEO, as it emerges from the 1988 INC. compensation survey.

INC.'S GUIDE TO WRITING YOUR OWN TICKET

How to take down the big bucks—while keeping investors, bankers, and the taxman smiling

BY PAUL B. BROWN

CHARLES LAZARUS OF TOYS 'R' US MADE $60 million last year. Jim P. Manzi of Lotus raked in $26.3 million, and wine maker and author Lee Iacocca found a total of $17.9 million coming his way.

You work just as hard running your company as they do running theirs. So you should make that kind of money, too—right?

Well . . .

OK, you decide you can live with just a fraction of what these guys find in their pay envelope each week. But exactly how large should that fraction be?

That's the question facing people who run their own companies, and unfortunately there is no terrific answer.

Surely, if you pay yourself $4 million a year and your company grosses only $3 million, you're going to raise some eyebrows—your banker's, your stockholders', your venture financier's.

You'll also probably discover that the IRS wants to chat.

The government's position on paying yourself too much is simple. If you got $500,000 last year for a job that was only worth $125,000, the Internal Revenue Service is going to treat the "extra" $375,000 as a dividend. This, for the feds, is better than discovering that Christmas comes twice a year. You—as an employee—are going to pay personal income tax on that $375,000. Plus, your company won't be allowed to deduct the $375,000 as a business expense. Salaries are deductible. Dividends ain't. If ever you wanted to make a case for eliminating the corporate income tax, this would be it. As the example shows, the same income is being taxed twice, once when the corporation makes a profit and again when that profit is received as salary.

But the friendly folks at the IRS aren't overly concerned about tax theory. They're worried about you living too high off the hog. Their official position is this: you can pay yourself a nice salary, as long as it is "reasonable compensation" for the work done.

The problem with that is obvious, says Ronald Neill, a partner at Calfee, Halter & Griswold, a Cleveland law firm. "Reasonableness, like beauty, is in the eye of the beholder."

Swell. But all is not lost. Compensation experts say the following approach to writing your own ticket will keep the IRS at bay.

Step 1: Look around. The most important thing, they say, is to determine what your peers are getting. If you're running a $5-million toy company, find out what people who are running similar-size toy companies—not Toys 'R' Us—are getting. Then try to stay in the ballpark. While your competitors are not likely to turn over their W-2s, trade publications and associations probably do surveys that will let you know what they make.

Step 2: Leave a paper trail. Having set your salary, be sure to spell out in writing how that decision was made—and have somebody at arm's length approve it.

"The IRS doesn't want to take on a company's board of directors," says Arthur F. Farwell III, vice-president at The Johnson Cos., a management-compensation and benefits firm in Langhorne, Pa. "If the board has reviewed the plan, then the company has a stronger case" when the IRS comes to call.

Step 3: Plan ahead. Set your compensation plan early in the year. If you wait until December to come up with a way to dispose of that extra $375,000 the company finds on hand, the IRS is likely to say it isn't a bonus, but a dividend.

"It isn't so much the semantics as having a reasonable program," says Farwell. "If the track record has been to pay out 20% of profits each year, and you suddenly find yourself with a hot product that makes that 20% a huge number, you are probably OK. But if you normally pay out 5% and this year it's 63%, that's trouble. There's no consistency."

The bonus as a percentage of sales or earnings, by the way, is one way the big-company boys pull down the serious bread. Charles Lazarus's base salary is "just" $315,000. But his contract provides an incentive bonus of 1% of corporate pretax profits over $18 million. That came to $3.2 million last year. (Stock options made up the rest of the $60 million.)

If you follow our three-step approach, your salary is likely to pass IRS muster, even if it suddenly jumps from $60,000 to $200,000. In such a case, says attorney Neill, you could argue that compared with other executives in your field, you were underpaid at $60,000. You could also say that a good hunk of that compensation came in the form of incentive compensation, which was set in advance and agreed to by your independent board of directors.

SETTING COMPENSATION:
*The factors that matter most**

Company profitability	77%
[illegible]	[illegible]
Company's capital needs	30
[illegible]	[illegible]
Partners or board of directors	22
[illegible]	[illegible]
Taxes	17
[illegible]	[illegible]
Effect on top management	6
[illegible]	[illegible]

*Totals exceed 100% because of multiple responses.

A company's profitability, far more than any other factor, determines how CEOs pay themselves.

Still baffled about how much you should be paid? Ask your banker. If you're running a $5-million company that's making 10% pretax, the subject of your salary may not even come up when your company applies for a loan, says Jack Leahy, a vice-president at Chase Manhattan Bank, in New York City. "But say that company is only making $40,000. Then one of the things we're going to look at is what the entrepreneur is paying himself," he says. "If the

chairman is taking out $400,000, then obviously the company has some flexibility on the number it brings to the bottom line. In this case, we may set a limit on what the salary should be." That limit won't be expressed in terms such as reasonable compensation. The bank will talk numbers—stipulating that pay is "not to exceed $100,000," for instance. If you pay yourself more, they'll call the loan.

And if you are thinking about getting around either your banker or the IRS by taking less salary but making it up in fringes, think again. While you may have gotten away with it in the past, you no longer will. Now, there's a whole series of tests used by the IRS that prevents you from favoring yourself in fringe-benefit plans. What you give yourself, you have to give to all your employees.

The issue of executive compensation is of particular importance to heads of companies in the throes of growth. While we don't know many CEOs at billion-dollar companies who complain about their compensation, many growth-company heads—indeed, 45% of the people responding to our survey—thought they were underpaid. There's a good reason, of course. If your company is growing

INSIDE THE MIND OF THE IRS

Confessions of an inquisitor

Be forewarned: if Jim Brennan shows up at your door, you're in trouble. His visit is a message, a signal that the Internal Revenue Service is ready to take you to court. Shoveling greenbacks out of the business? Splitting your company into three different corporations, then taking a full-time chief executive's salary from each? Or are you the frugal type, saving a few bucks by paying out profits through tax-deductible salary and bonus rather than through dividends taken from aftertax income? If the IRS thinks so and decides your offense is so flagrant it has no choice but to prosecute, it'll send in Brennan—CEO of Brennan, Thomsen Associates Inc. and a professional compensation expert—to show you the error of your ways, be it envy, avarice, or pride.

By law you're allowed "reasonable" compensation, "the amount that would ordinarily be paid for like services by like enterprises under like circumstances." Brennan will set a dollar figure, rationally, based on an extensive survey of like companies in like situations, and then, if necessary, he'll testify as the IRS's expert witness in court.

It is rarely necessary. Of the 60-some cases Brennan has seen in the past eight years, only 6 actually went to trial. Forty percent were settled as soon as the IRS announced it was bringing him in.

It takes a foolish taxpayer to battle the IRS much further, of course. Unlike your garden-variety felon, who is presumed innocent unless proven guilty, a CEO in tax litigation stands guilty before the first gavel falls, forced to disprove the agency's charges while facing the prospect of whopping legal fees along with the penalties and interest on the tax bill. But the IRS doesn't want to go to court any more than the taxpayer, Brennan insists. "The IRS is reasonable. They aren't given to quibbling. Usually they're more generous with the taxpayer than I could support as an expert."

The challenge is getting the taxpayer to be reasonable, too. "People let their egos get involved, and that's a trap. They feel they're being judged as deficient. They say, 'This is *mine*,' and feel their personal validation is threatened."

At that point reason usually flies out the window. How else to explain the taxpayers who spent thousands producing a movie showing just how vital they were to their companies, even though the judge was blind? Or how about the former fast-food fry chef who took over an adult-film company when the founder was forced to divest or face criminal prosecution, then claimed $269,000 a year (hazard pay for a job that could lead to the slammer)?

Outside the courtroom Brennan looks too good-natured to be an inquisitor. A smiling, round-faced 42-year-old with prematurely gray hair and thick glasses, he works out of a cluttered second-floor walk-up just down the mall from the Fantastic Sams haircutting franchise in suburban St. Louis. But taxpayers underestimate his reputation only at their peril. His custom-designed pay programs have been singled out for praise by Congress, the General Accounting Office, and a roster of private clients.

Brennan can predict in advance what he'll hear when the IRS calls. The company will be small, always less than $50 million in sales, usually in the $20- to $30-million range. It will be run by stockholder officers who set their own pay, in many cases meaning well, but ultimately deceiving themselves. They may believe they are "the best in the field," as one CEO pleaded, but that doesn't mean they deserve twice as much as anyone else in their industry, particularly if their company is only one-fifth the size of its competitors.

Some fall victim to "the proprietary trap," Brennan says. "They see their friends with sole proprietorships or partnerships that have drawing accounts and vacation houses, and want the same things. They think, 'By golly, this is *my* company. I made the money and I can do what I want with it. This is America.'

"But that's a fundamental misunderstanding of the discipline of corporations. A corporation ain't the same creature as a sole proprietorship."

Others are too generous to their children. It's unreasonable, Brennan says, for a parent in a $20-million company to pay his general counsel/son $500,000 a year while the boy is still in law school, or for another to decide his daughter is "vital and essential to the company's management" and worth $200,000 a year for flying the company plane on family vacation trips.

Equally unreasonable, and more common still, are children who are too generous to themselves—like the cosmetology student who took a $15,600 job as secretary in her father's business, then boosted her salary to $297,500 the year after the old man retired. Brennan doesn't expect children in a family business to sacrifice like their parents did, working out of a garage, pouring body, soul, and every available nickel into the company. "But the kids want to live high right away"—another lapse of discipline.

Brennan works blind, creating a competitive analysis of compensation in similar companies without knowing the actual salary of the taxpayer in question. Starting with sales revenue, structure, number of employees, number and title of subordinates, stock history, dividend record, profit, assets, capital, and debt, he'll turn to publicly available survey information from the Executive Compensation Service, the Conference Board, or INC.'s Executive Compensation study, looking for the closest match he can find. "I start by presuming I represent the other side—and give them the most generous assumptions," he says. The IRS is more generous still. "They aren't interested in what's the average compensation, they want to know what's the *highest* anybody is paid." If you're not above that figure, you're probably safe from the court. *—Curtis Hartman*

quickly, you tend to use what little money there is for new copiers, not to give yourself a raise.

But ironically, paying yourself too *little* can worry the outside world, too.

"Most people starting a company know nothing about a lot of things, including what they should pay themselves," says Dallas venture capitalist L. J. Sevin. "It's not a huge issue" if you should set your compensation low, "but it does show a lack of judgment."

Sevin won't mind if you pay yourself, and your staff, a fair wage. But he—like the IRS—doesn't want to see overpayments, either. "We want to see companies that can attract good people without paying them a premium. That tells us the folks who sign on are committed to the idea and are motivated."

But at some point, you'll want to be paid what you're worth. A little planning now will make that possible.

And for those who dream about the compensation of Reebok's Paul Fireman ($15.4 million), Waste Management's Phillip B. Rooney ($14.3 million), or GE's John F. Welch ($12.6 million), that planning will help you prepare your defense, in case the IRS arrives. □

CEOs BEHIND THE WHEEL:
The cars of choice

Cadillac	16%
Chevrolet	10
Mercedes-Benz	9
Ford	8
Oldsmobile	8
Buick	7
Lincoln	7

Among the CEOs surveyed, only Mercedes interrupts the preference for a 'made-in-the-U.S.A.' company car.

COMPENSATION FOR TOP OFFICERS BY COMPANY SIZE*

SERVICE

Annual revenues	CEO	COO	CFO	CMO
$10 mil. or more	$174,000	$105,000	$80,000	$71,000
$5 mil.–$9.99 mil.	145,000	71,000	51,000	75,000
$1 mil.–$4.99 mil.	105,000	69,000	45,000	67,000
Less than $1 mil.	59,000	55,000	30,000	46,000

MANUFACTURING

Annual revenues	CEO	COO	CFO	CMO
$10 mil. or more	$206,000	$114,000	$112,000	$95,000
$5 mil.–$9.99 mil.	126,000	72,000	73,000	67,000
$1 mil.–$4.99 mil.	100,000	60,000	41,000	56,000
Less than $1 mil.	62,000	60,000	42,000	66,000

WHOLESALE/DISTRIBUTION

Annual revenues	CEO	COO	CFO	CMO
$10 mil. or more	$150,000	$101,000	$59,000	$87,000
$5 mil.–$9.99 mil.	142,000	**	**	80,000
$1 mil.–$4.99 mil.	75,000	51,000	14,000	48,000
Less than $1 mil.	48,000	**	**	**

RETAIL

Annual revenues	CEO	COO	CFO	CMO
$10 mil. or more	**	**	**	**
$5 mil.–$9.99 mil.	$85,000	**	**	**
$1 mil.–$4.99 mil.	60,000	$35,000	**	$38,000
Less than $1 mil.	36,000	32,000	$13,000	28,000

OVERALL

Annual revenues	CEO	COO	CFO	CMO
$10 mil. or more	$181,000	$109,000	$91,000	$88,000
$5 mil.–$9.99 mil.	125,000	75,000	61,000	69,000
$1 mil.–$4.99 mil.	93,000	63,000	37,000	58,000
Less than $1 mil.	58,000	52,000	26,000	45,000

EXECUTIVE BENEFITS AND PERKS:
The benefits and perks that companies provided to their top officers

	CEO	COO	CFO	CMO
Company car & expenses	82%	65%	55%	70%
Supplemental life insurance*	64	63	60	57
Tax-return preparation	52	31	32	27
Club dues & expenses	43	27	27	27
Supplemental medical insurance*	40	40	39	38
Personal tax & financial planning	33	20	19	18
Low- or no-interest loan	25	18	19	18
Supplemental retirement benefits*	15	14	14	14
Deferred compensation	14	14	13	13
First-class air travel	11	6	6	6
Moving allowance	8	11	13	12

Among companies with at least $10 million in sales, manufacturers pay the most. But among businesses between $1 million and $10 million, it's the service sector that averages the highest in compensation for top officers. In companies under $1 million, manufacturing is again the leader.

*Figures rounded to the nearest thousand; ** Insufficient response for purpose of comparison

THE FACTS BEHIND THE FIGURES

This is the 10th consecutive year that INC. has conducted an executive compensation study. In early April, we mailed a four-page questionnaire covering salaries, benefits, bonuses, and policies to a random sample of 20,000 subscribers. Data Tabulation Services, Inc., of Boston and Stoneham, Mass., compiled the 1,700 usable returns.

A special report containing the complete results of the survey is available. The report—while preserving the confidentiality of the survey responses—provides detailed information not included in the magazine. To obtain a copy, please fill out the postpaid card bound in this issue, or send a written request and a check for $78 ($75, plus $3 shipping and handling) to INC. Executive Compensation Study, Attn: Mary Ellen Mullaney, 38 Commercial Wharf, Boston MA 02110, or call (800) 372-0018. In Massachusetts, call (617) 227-4700.

The survey was conducted under the direction of special projects editor Sara Baer-Sinnott. Research assistance was provided by Leslie Brokaw.

YOU GET WHAT YOU PAY FOR

If you want money to talk, you'd better be clear about what it's supposed to say

BY BRUCE G. POSNER

FIVE YEARS AGO—A COUPLE YEARS SOONER THAN most people—Jim Bernstein found Truth.

By then his young business had survived its infancy and, as a provider of health-risk information to insurance and industrial companies, had become steadily if unspectacularly profitable. Now, Bernstein wanted more. He wanted General Health Inc. to grow. But how to make that happen? he wondered. Then it came to him, the managerial magic wand that could transform stasis into growth: *incentive compensation.*

It made such simple sense. You want your company to get from *A* to *B*. More important, you want your employees to want your company to get from *A* to *B*. So you put a price, a reward, on *B*'s head—a bounty no respectably materialistic worker could ignore. Then you watch your people gun for it.

What Bernstein wanted, specifically, was for General Health's revenues to grow from $1.8 million to $2.7 million in a year. The company's margins were firm, so it stood to reason that the sales growth would convert into profit growth. Perfect. The company would blossom. Life would be sweet.

With this happy sequence in mind, Bernstein promised all 30-some employees that, if the company hit the sales target, each would get an extra month's pay.

It worked. In fact, it worked *too well*. The incentive plan had immediate impact. "It was incredibly motivating," Bernstein recalls. Instantly, General Health began booking business faster than ever before. Unfortunately, it was soon evident that the increased volume was creating problems. As sales shot up, the expense of generating and servicing the new accounts—the product literature, computers, support staff, and so on—also went crashing through the roof. The company's bottom line, which had habitually shown 10% pretax profits, turned dangerously red. "We thought there were enough mechanisms in place to control our costs," explains Edwin Russell, a director who headed General Health's compensation committee. "But the volume of orders was creating amazing pressures to spend money."

Luckily, the company addressed the problem before it was too late. Bernstein installed a new incentive program—one that balanced the desire for growth with the need to control costs and maintain adequate cash flow. Salespeople were still encouraged to bang down doors, but other employees were rewarded both on the basis of company profits and on their ability to meet specific goals. The manager in charge of computers, for instance, was measured by his ability to meet his budgeted cost structure. "The thing about incentive plans," says Bernstein, shell-shocked but wiser, "is that people take notice. You can meet your goal—and run yourself right out of business."

Bernstein is not the only CEO who has found this out. All across America, managers just like him have been flocking to incentive systems—often called pay-for-performance plans—in a spirited attempt to simultaneously fire up and control the businesses they're trying to build. The idea isn't new. It's been around ever since managers began fretting about the consequences of boosting pay without bettering results. But only in the past few years has the notion of putting significant dollars at risk become the norm. Nowadays, says Lester B. Jackson, president of Compensation Consultants Inc., in Scottsdale, Ariz., "entitlements are out. Companies want improved results before they hand out pay increases, and there's more willingness to experiment."

What once was an avant-garde idea has quickly become conventional wisdom. The genie is out of the bottle, and it's almost inconceivable that it will go back in. Companies such as General Health have lived with incentives for a while, and we're beginning to see how they work. Incentive compensation, *in practice*, has a history. And history has its lessons.

As the General Health episode suggests, getting incentive plans in proper alignment can be difficult. Not that the principles themselves are flawed. If anything, experience shows they're more persuasive than imagined. "People are going to try to take you where the money is, whether you like it or not," says Jim Mullis, a principal and compensation consultant with Ernst & Whinney, in Atlanta. So you'd better be comfortable with where you want to go.

At many businesses, the problems begin right away, with the definition of company goals. Most CEOs have an intuitive sense of the direction they want to move—be it increasing sales or profits, or improving quality. If you've never experienced the power of incentives, picking a goal might seem tame. The risk, however, as General Health found, is that setting up one objective against all others can unleash forces beyond your control. When General Health began pushing sales, the feeling was that profits would take care of themselves. After all, Bernstein understood the cost structure of the business—or so he thought.

In retrospect, notes director Russell, one might have anticipated that the drive for sales

▶ STORY ◀ PROPOSAL

Just a few years back, incentives were hot. Pay-for-performance plans were the cutting edge of compensation strategy. The press hyped them. Managers tried them. Consultants got rich off of them.

What's happened since? Were incentives, as advertised, the panacea for workforce ills? How did they operate when companies actually used them? In other words, has practice lived up to theory?

Let's find out. —B.G.P.

would throw things out of whack. After all, the name of the game was booking orders, not saving paper clips. "Ask people to focus on *X* and they go hell-bent for leather on it," Russell says. "They forget about *Y*."

So there's a lesson here: before picking a goal, prepare yourself for what will no doubt happen when people begin shooting for it. Depending on the circumstances, you may want to rethink your objective or at least figure out how to monitor what happens. "Unless you watch it," says Mullis, "incentives can take on a life of their own."

It would be nice if having the right goals was all you needed to make incentive plans work. Unfortunately, successful goal selection is just the beginning. Companies get equally snarled up in figuring out the best ways to measure progress toward those goals. For better or worse, the technique you use for keeping score—both for the company as a whole and for individuals—is critical. It sets the course. And the wrong yardstick can be just as dangerous as the wrong goal.

Consider, for example, what happened at Lillard Co., a $30-million heating and air-conditioning distributor based in Concord, Calif. Lillard's was a case of the right goal but the wrong way to measure it. For many years, Lillard rewarded its six branch managers on the basis of gross profits they generated in their own territories—the profit on products sold, before deducting operating expenses, which were paid by headquarters. The problem was that what triggered the bonus wasn't the gross profit *dollars*, it was the percentage *margin*.

CHANGING STRATEGIES:
Looking to compensation for an edge

Companies with a performance appraisal system that made changes in it	16%
Companies with an annual incentive program that made changes in it	12
Companies without a performance appraisal system that are planning to develop one	11
Companies without an annual incentive program that are planning to develop one	12

A lot of managers are reconsidering how they pay their employees.

During the 1970s and early 1980s, when the company was growing, it didn't seem to matter that bonuses were calculated in this manner. "High volume led to high profit," notes Bob Callegari, vice-president for operations, so the company was covered. Headquarters was getting enough cash from the branches to easily handle branch expenses, pay out incentive awards, and have something left over. But in 1983, the market softened in some parts of California; paying bonuses that were indexed according to gross margins became suicidal. The percentage margins were still there, but low volume meant that the dollars weren't. "We had managers who were getting bonuses even though their branches were *losing* money after expenses," says Callegari. "In a bad market, it was like writing checks on a zero balance."

Given the circumstances, then-owner Emery Lillard decided to make fundamental changes. The first thing he did was scrap the margin system and begin basing the branch managers' bonuses on gross profit dollars. Then, in an attempt to upgrade their management skills, Lillard went a few steps further. He also tied their pay to return on assets, and to inventory and receivables management—things they had never had to worry about under the previous compensation system.

Clearly, says Callegari, the new measurement system was more demanding of managers, and some of them were apprehensive about the change. Every month, for instance, they saw their own P&Ls. The higher their return on assets, the bigger the slice of gross profits they got to keep—up to 35%. "But after a year or so," he says, "everyone was doing as well or better than before. And the company became a lot more profitable."

Once you get it right—suitable goals, good ways to keep score—you can hope that the most difficult part is over. But don't count on it. The track record shows that the most difficult part may be when performance prevents the rewards from kicking in.

Some compensation specialists say the decision should be easy. "If a guy falls flat on his face, you have to be willing to say, 'Tough luck,' " argues Eugene Nawrocki, a consultant at The Wyatt Co., in Wellesley, Mass. Sounds reasonable, but what about morale? How do you balance commitment to the plan with fear of mutiny?

Very gingerly, says Mike Guthman, partner at Hewitt Associates, in Rowayton, Conn., especially when you're dealing with people you don't want to lose. "If a plan isn't paying out and people think it should be, then you've got to deal with that," he says. It doesn't matter if the problem is the result of an act of God or an unfortunate decision. "Letting the chips fall" isn't always possible.

The truth is that there's no easy way to make incentive plans work—not if you want to stay in control of the business. But just being aware of that should give you a head start. "Once you're out where the rubber meets the road," says Donald T. Sagolla, principal in charge of management consulting at Peat Marwick Main & Co., "you can't just hold people to three or four objectives and stand back. There's a lot of managing to do, and as we know, managing takes two things: time and courage." □

POSNER'S LAWS

Creating incentives for your company? Here's what to think about

Now that we've lived with them a while, two things about incentive compensation plans are certain:

1) They work.

2) Because they work, you'd better be careful about exactly how you set yours up.

So here's help. The troubles companies have had with *their* incentive programs suggest keys to keep in mind as you devise a system of your own.

Don't copy. Every company is different, which means every plan probably ought to be, too. What's more, most plans have problems, so if you mimic one, you'll run the risk of magnifying its mistakes. This doesn't mean you can't get *ideas* from competitors—just be skeptical about using them.

Make the goals different for everybody. Wonderful as it sounds to have everyone shooting at the same target, it's important to go the next step and define objectives for individuals, too. In the company's revised plan, for instance, General Health Inc. tied the product development manager's bonus to meeting tight schedules.

Poke holes in your system. If you devote some time to thinking about the weaknesses of your completed plan, you'll end up with a better one. Had General Health done this, for example, the company might have installed better cost controls before forging ahead.

Don't walk away. Incentive plans send strong messages to people, so make sure they're hearing them right. Keep in especially close touch with employees *as* the plan is being implemented. Listen to their reactions. Remember that it takes time to communicate both the spirit of the system and how it works, so be sure you're prepared to give it.

Follow the money. When the plan starts paying out, see who's getting the bonuses. If the rewards aren't going to the people you expected, you may be rewarding the wrong kind of behavior. Even before you get to this point, give some thought to what you'll do if it appears your plan is having unintended effects.

HANDS ON

A Manager's Notebook

MANAGING PEOPLE

A BUSINESS CARD IN EVERY POCKET

It's an old but true bromide: employees who are proud of what they do make better workers. Here's another easy way managers can help instill that feeling: make sure everyone has personalized business cards.

"A batch of cards costs us only $20," says Nancy Vetrone, president of Cleveland-based Original Copy Centers Inc., "and it's a hell of a simple way to recognize each person as important." Vetrone hand-delivers the cards to new employees within a week of their joining the company—a gesture that welcomes them to the permanent team.

The cards are also a cheap method of marketing, she says. "We've put 94 times more cards out in the world through our 94 employees. You never know who your people know." □

WHAT WAGES ARE WORTH

Work time needed to pay for:
(in minutes unless otherwise specified)

	WASHINGTON	MOSCOW	MUNICH	LONDON
Sirloin steak, 1 kilogram	83	195	93	123
Tuna, 1 kilogram	36	183	40	51
Potatoes, 1 kilogram	9	11	5	3
Fresh milk, 1 quart	4	20	6	6
Car, midsize (months)	9	84	12	15
Man's two-piece suit (hours)	18	118	33	16
Color television set (hours)	30	669	54	75
Movie in a suburban theater	40	28	42	52

Source: National Federation of Independent Business Foundation, 1987

OPERATIONS

BIGGER CARROT, BETTER RESULTS

Have you ever wondered whether the awards you use to motivate employees just won't do the job? Walter Riley, president and CEO of Guaranteed Overnight Delivery Inc. (G.O.D.), in Kearny, N.J., looked at the less than stellar safety records of his company's drivers and began thinking.

G.O.D.'s delivery trucks were averaging six accidents a month. The pin, patch, plaque, and $50 driving-record rewards, typical for the industry, were fetching typical accident records. "I didn't want to be *typical*," says Riley. "I wanted to get rid of the fender benders that added up to a lot of grief."

And a lot of money. Riley estimates that in 1987 he spent $130,000 on repairs. "But it's the intangibles that were even more costly—meetings with lawyers and insurance people, filling out forms, and lost driving time for starters." All that brought the cost of the accidents to perhaps $400,000, Riley says. When he realized he was spending only $350 on his safe-driving program, he figured his cheapness might be the problem.

So he bought a 35-foot-long motor coach for vacation use by drivers who worked a year without an accident. After Riley unveiled this new carrot, the accident rate plummeted 89%. Because the plan is so new, total savings can't be calculated, but Riley is confident that they'll cover the monthly payments on the $90,000 fully loaded vacation on wheels. □

PERSONNEL

KEEPING THE INJURED INVOLVED

Do you write off injured workers—approve the workers' compensation claims, shuffle in replacements, and forget the wounded until their months on the dole are over? If so, you may be missing an opportunity.

Employees who are injured on the job don't necessarily have to be lost to workers' comp, says Thomas Lynch, of Lynch, Ryan & Associates Inc., a benefits consulting firm in Westboro, Mass. Companies can bring many of the injured back to do light tasks around the factory or office, thereby raising productivity, lowering insurance costs, and boosting morale at the same time.

"Think about tasks you've always wanted done but never had people around to do," Lynch says. "Weed through them: some can be done seated, others with one hand."

Then, says Lynch, negotiate a temporary job description together with the injured employee and his or her doctor. In cases in which light or restricted work is possible, Lynch claims that many employees will accept the offer. "People *want* to work, they want to feel useful," he says.

And the business's benefit? In addition to getting worthwhile tasks accomplished, companies that routinely pursue this policy—and have at least 80 to 100 employees insured under what is known as a loss-sensitive plan—can receive refunds of 40% or more on their annual workers' compensation premiums, according to Lynch. Smaller companies usually don't qualify for refunds, but they may eventually get lower premiums. □

HIRING

SCOUT'S HONOR

Looking for clues in a job applicant's past that might predict his or her future performance? Here's an unusual one.

After hiring many of the more than 70 employees for Super Wash Inc., her car-wash chain in Morrison, Ill., Mary Black has found 4-H and Scouting experience to be two of the more reliable tip-offs to likely roll-up-the-sleeves workers—and ones with leadership abilities to boot.

"Scouts know how to work with a team and be independent at the same time," she says. "And 4-H members are used to keeping detailed records of their projects. My head accountant is a 4-Her, and she's incredible." Recently, Black hired an Eagle Scout to be quality-control inspector. And she herself was a Senior Girl Scout.

When it dawned on Black that many of her best workers had the Scouting/4-H experience in common, she began looking for it. And though she's quick to point out that hiring decisions aren't based on that résumé item alone, she claims it has yet to steer her wrong. □

CHARTS: CYNTHIA DAVIS

HANDS ON

LAW

POLYGRAPH TESTS BANNED

If you use polygraph tests to recruit or manage your employees, start thinking of alternatives. On December 27, 1988, a new federal law takes effect that virtually bans private-sector use of the tests.

Lie detectors will no longer be permitted as a means to prescreen job applicants. The only exceptions: applicants for security and pharmaceutical jobs. Companies will have to rely on such screens as background checks and written tests to gauge honesty.

Use of polygraph tests to investigate stealing and other infractions *is* permitted, but the employee must first receive a written notice stating that he or she is "reasonably" suspected of committing the infraction. The employee can refuse the test or terminate it at any time. Since the law does not define reasonable suspicion, experts advise using lie detectors sparingly to avoid lawsuits. □

FINANCE

GETTING BILLS PAID EARLY

Having trouble with customers who take their early-payment discount even when they don't pay early? Carl Hansen, president and CEO of Viking Engineering Inc., a Tarpon Springs, Fla., manufacturer, has a solution.

Instead of detailing the discount on an invoice, making it tempting to take the discount regardless of when paid, Hansen prints his early-payment price offer only on an eye-catching green coupon included with each bill. The separate coupon prevents payables clerks from honestly confusing the discounted price with the regular, net-30 billing. It also, says Hansen, "psychologically grabs the customer and bumps us up on the list of people to be paid."

Apparently, it works: Viking's average bill is paid in a respectable 35 days—down from 55. □

QUOTE OF THE MONTH

'The biggest enemy is doubt. If you don't believe in what you are doing, you aren't going to make it.'

—Philippe Kahn, president and CEO of Borland International Inc., a Scotts Valley, Calif., software-industry pioneer whose sales grew from $38 million in fiscal 1987 to more than $81 million in 1988

MARKETING

WHEN LESS IS MORE

Test-selling a product for possible addition to your line can be dangerous. If you add the item, you'll buy big quantities to get the best price. But if it doesn't move during your test, you can be stuck with an unsalable inventory. Which is why, says Stew Leonard, paying more is sometimes a better deal.

Before Leonard places a big order for a new item, he'll order a smaller lot and sell the item for less than he paid. "Sure I lose a little money, but I find out if it really is a good deal," says the Norwalk, Conn., retailer. "If I sell out, I'll buy the truckload. If I don't, I'm not stuck with something I can't sell."

It's a lesson he learned the hard way. "We were offered a truckload of shaving cream at 99¢ a can, or 10 cases at $1.39. I took the truckload because I was sure we'd sell out. We didn't. I initially priced it at $1.19. I finally sold it at 69¢, buy two get a third one free." □

WHAT IT REALLY COSTS EMPLOYERS

COMPENSATION COMPONENT	ALL PRIVATE INDUSTRY	GOODS INDUSTRIES	SERVICE INDUSTRIES
Legally required*	$1.13	$1.43	$1.01
Paid vacation and leave	.93	1.09	.87
Insurance	.72	1.02	.60
Pension and savings	.48	.64	.41
Other benefits	.02	.04	.01
Total benefits	3.28	4.22	2.90
Wages, salaries and bonuses	10.15	11.65	9.52
Total compensation	$13.43	$15.87	$12.42

*Social Security, workers' comp, unemployment insurance, disability, and Medicare

Above are the average hourly employer costs for employee compensation, by major industry groups, according to a 1987 survey by the U.S. Bureau of Labor Statistics.

BANKING

OPEN COMMUNICATIONS

If you're like many CEOs, you'd like to make communications between you and your lending institution a two-way street. Terry MacRae, cofounder and principal of Hornblower Yachts Inc., in San Francisco, has found a way: meet regularly with everyone from your loan officer to the bank president. Once a quarter the bankers get to see just what their loans are buying, and MacRae gets to check out how *their* portfolio's doing, what management changes are underfoot, and how their short- and long-term plans are coming along.

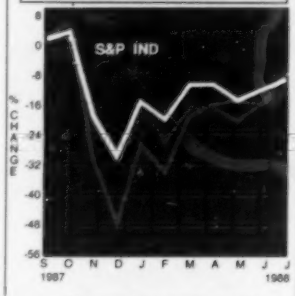
"When you ask what's new," says MacRae, "it's surprising what they'll tell you." He learned during one meeting that his bank would soon acquire another bank—and he was able to plan an extra cushion of time to process his next loan application.

Don't be afraid to turn the tables and make requests of your bank. "They're selling a service, and you're paying for it," admonishes MacRae. "You have the right to ask for certain things without being bashful." □

Reported by Leslie Brokaw, Paul B. Brown, Teri Lammers, and Stephen D. Solomon

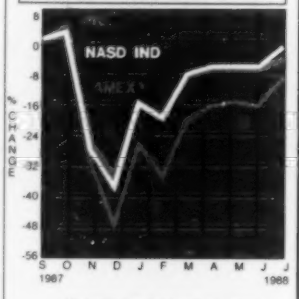
INVESTING IN GROWTH COMPANIES

INC. vs. CONSERVATIVE AVERAGES



All averages start at 0 in October 1987

INC. vs. SPECULATIVE AVERAGES



All averages start at 0 in October 1987

IPOs IN THE AFTERMARKET

To July 1, 1988

INITIAL PUBLIC OFFERINGS: JUNE 1988

O-T-C sym.	Company	Business/product	Offering Size ($mil.)	Offering Price	First aftermarket bid	Underwriter
AZL[a]	Arizona Land Income	Real-estate investment trust	24.00	10.00	10	Young Smith Peacock
ATCEU	ATC Environmental	Provides environ. svcs.	3.60	9.00[b]	21	Graystone Nash
DELL	Dell Computer	Designs & mfrs. IBM-compat. PCs	36.13	8.50	9⅝	Goldman, Sachs
DSF[c]	Dreyfus Strategic Govt. Income	Closed-end fund	156.00	12.00	12	Paine Webber
DEMP	Drug Emporium	Operates discount drugstores	21.75	14.50	15½	Furman Selz
EGGS	Egghead	Retails PC software	61.20	17.00	19¼	Donaldson Lufkin
ELE[c]	Empresa Nacional	Produces electricity	172.06	12.29	13¼	Goldman, Sachs
EWSCA	E. W. Scripps	Diversified media co.	108.00	16.00	16½	First Boston
LFSA[c]	First Federal S&L of Lenawee	S&L	4.28	8.00	8¾	McDonald & Co.
GCR[a]	Gaylord Container	Mfrs. corrugated paper prods.	77.90	20.50	20½	Salomon Bros.
GMIC	General Microelectronics	Mfrs. & mkts. supercomputers	5.00	4.00	4¼	Keane Securities
HVDK	Harvard Knitwear	Mfrs. women's & children's clothing	4.73	5.25	5¼	L. C. Wegard
HUHOU	Hughes Homes	Retails mfr. houses	3.60	9.00[d]	8¾	Paulson Investment
INDX	Index Technology	Designs, develops, & mkts. software	19.20	12.00	13¾	Hambrecht & Quist
KNCI	Kinetic Concepts	Mfrs., & rents specialty beds	44.63	10.50	10⅞	Morgan Stanley
MAROU	Marrow-Tech	Develops tech. for replication of bone marrow	6.00	5.00[e]	5	D. H. Blair
MSHK	Medstone Int'l	Produces & mkts. medical equip.	13.00	13.00	16	Weedon & Co.
MIND	Mindscape	Publ. software prods.	9.90	9.00	9⅛	William Blair
ODEP	Office Depot	Operates office supply stores	21.00	10.00	12⅜	Merrill Lynch
PNF[a]	Penn Traffic	Operates supermarkets	25.33	14.00	14	Salomon Bros.
PTEC	Phoenix Technologies LTD	Designs, develops, & mkts. software	49.50	15.00	15½	Montgomery Securities
PGT[c]	Putnam Intermediate Government Trust	Closed-end fund	600.00	10.00	10	Shearson Lehman
RRR[a]	Residential Resources Mortgage Investment	Real-estate investment trust	65.00	10.00	10⅛	Donaldson Lufkin
SNF[c]	Spain Fund	Closed-end fund	39.00	12.00	12⅛	First Boston
STLT	Stolt Tankers & Terminals	Commercial shipping	49.20	10.25	10⅛	Shearson Lehman
USAS	USA Waste Services	Solid waste mgmt. co.	5.25	4.63	5⅛	R. B. Marich

Initial public offerings sold at $1 or less not included; issues without underwriters not included. First aftermarket bid is approximate. [a] trading on AMEX, [b] units of 3 common + 1 warrant, [c] trading on NYSE, [d] units of 2 common + 1 warrant, [e] units of 3 common + 3 warrant. Offering data source: *GOING PUBLIC: THE IPO Reporter*, a publication of The Dealer's Digest Inc., 150 Broadway, New York, NY 10038

CHARTS: IMAGEBUILDER DESIGN

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